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## Federal Incorporation of Railroads

ONE of the most important public utility problems now before the American people is the proposal of the railroads that Congress enact legislation compelling each railroad to any extent engaged in interstate commerce to secure, in lieu of its present state charter, a charter from the Federal Government.

As nearly every railroad in the United States is to some extent engaged in interstate commerce, this proposal would result in the transmutation of practically every railroad corporation in this country from a state corporation to a federal corporation.

The proposal for federal incorporation of the railroads presents some very interesting questions.

Is the withdrawal from the states of practically all their powers over railroads—the avowed purpose of the federal incorporation plan—desirable?

What will be the effect of federal incorporation of the railroads on the powers new exercised by the states with respect to purely state commerce?

Will the federal incorporation of the railroads enable the railroads to remove themselves from state jurisdiction over purely state commerce, without amending the commerce clause of the Constitution?

Is the particular plan of federal incorporation advocated by the railroads in the public interest?

What would be the effect on railroad rates and on the compensation hereafter to be paid by the Federal Government for the railroad properties, if Congress should now enact legislation in effect compelling all railroads to take out national char-

ters under a plan which perpetuates all outstanding railroad securities including all the water therein?

These and many other interesting questions are involved in the plan of federal railroad incorporation which is being urged by the railroads before the Newlands Joint Committee of the Senate and of the House of Representatives.

It is not my purpose in this paper to discuss the merits of the proposal of the railroads to take from the states practically all their powers even over purely state railroad business. This is a subject of very great importance which merits consideration in a paper devoted to that subject alone. It is my purpose to consider in this paper, as succinctly as possible, the other questions just suggested.

## The Newlands Plan.

For several years, Senator Newlands of Nevada has been urging the enactment by Congress of legislation providing for the federal incorporation of railroads. Such incorporation, however, is to be only part of a comprehensive plan for the regulation of the relationship between the railroads and both federal and state governments, the railroads and their patrons, the railroads and their security holders, and the railroads and their employees.

The plan of Senator Newlands provides that any railroad corporation may secure a federal charter, but only with the consent of the parent state; that the states shall retain their power to regulate the rates of purely state commerce and their power to enact police regulations with reference to such commerce; that the physical properties of the railroads shall continue to be taxable by the state wherein such properties are located; and that the new federal railroad corporation shall issue, in exchange for the property of the state railroad corporation, securities not exceeding the fair value of the property to be transferred, as such value may be determined by the Interstate Commerce Commission.

The Newlands plan also provides for the establishment of an accident and insurance fund for the benefit of employees; for action by the Interstate Commerce Commission as a board of conciliation between the railroads and their employees; for the limitation of dividends to seven per cent on the outstanding

capital stock; and for the application of net earnings in excess of such dividends to betterments, extra dividends, or future inadequacy of earnings, as directed by the Interstate Commerce Commission.

## The Railroad Plan.

The plan of federal railroad incorporation now being urged by the railroads before the Newlands Joint Committee, omits, in my opinion, most of the commendable features of the Newlands plan and apparently has in view solely the withdrawal of the railroads from the jurisdiction of the states and the perpetuation, by direct compulsion of the Federal Government, of all their outstanding securities, whether issued for value or not.

While the railroads have not as yet presented the details of their plan, its broad outlines clearly appear in the testimony thus far presented by them to the Newlands Joint Committee.

The railroads urge the enactment by Congress of legislation providing, in effect, that after a day certain no railroad in the United States shall be permitted to continue to engage in interstate commerce, unless it has secured from the Federal Government a charter under a statute to be enacted by Congress; that such incorporation is to be compulsory, as distinguished from elective; and that the consent of the state from which the railroad holds its charter shall not be necessary.

The states are to be deprived of all their powers over railroads with reference to rates, service, safety, equipment and facilities, the issue of securities and every other matter affecting purely state commerce as well as interstate commerce, except that, as a matter of policy, the states are to be permitted "for the present" to retain their power to tax railroad property located within their borders and to exercise police powers over railroads in matters which are "not vital."

The new federal railroad corporation is to acquire the property of the existing state corporation subject to all outstanding bonds and other indebtedness and is to issue its capital stock in an amount equivalent to the entire outstanding capital stock of the state corporation. In a word, all the outstanding securities of the existing state railroad corporation, entirely without regard to their relationship to the fair value of the property or to the existing relationship between bond capital and share

capital, are to be perpetuated in the form of the existing indebtedness and new capital stock is to be issued by the federal railroad corporation in an amount equivalent to the entire outstanding capital stock of the state railroad corporation without any regard whatsoever to its fair value, this to be done under compulsion of the Federal Government.

Each existing state railroad corporation is to be converted into a federal railroad corporation, so that, except to the extent to which mergers or consolidations may later be authorized, there will be just as many federal railroad corporations as there are now state railroad corporations.

EARLY FEDERAL RAILROAD CORPORATIONS.

In four cases, ranging between 1862 and 1871, the Federal Government heretofore incorporated federal railroad corporations. In each of these instances, the railroad was incorporated by special act of Congress for the purpose of connecting the Middle West by rail with our Pacific Coast possessions and in each instance the Federal Government, by means of land grants and other considerations, gave generous assistance to the new railroad.

The first federal railroad was the Union Pacific Railroad Company, which was incorporated by Act of Congress of July 1, 1862, for the purpose of constructing a railroad from the 100th meridian east of Greenwich, west, to connect with Central Pacific Railway Company, a California corporation.[1]

The second federal railroad was the Northern Pacific Railroad Company, which was incorporated by Act of Congress of July 2, 1864, for the purpose of constructing a line of railroad from Lake Superior to Puget Sound, in the State of Washington, with a branch line to Portland, Oregon.[2]

The third federal railroad was the Atlantic and Pacific Railroad Company, which was incorporated by Act of Congress of July 27, 1866, for the purpose of constructing a line of railroad from Springfield, Missouri, to Albuquerque, New Mexico, and thence to the Colorado River and to the Pacific Ocean. In the same act, the Southern Pacific Railroad Company, a Cali-

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[1] 12 Stats. at L. 489.
[2] 13 Stats. at L. 365.

fornia corporation, was authorized to connect with the Atlantic and Pacific Railroad Company at the California state line.[3]

The fourth federal railroad incorporated during the period hereinbefore referred to was the Texas and Pacific Railroad Company, which was incorporated by Act of Congress on March 3, 1871, for the purpose of constructing a line of railroad from Marshall, Texas, to San Diego, California.[4]

## Legal Problems.

The proposed federal incorporation of the railroads presents a number of very interesting legal problems.

That the Federal Government has the power, whenever deemed necessary in the exercise of a governmental function, to create a corporation has been unquestioned ever since the decision of the Supreme Court of the United States in the leading case of McCulloch v. Maryland.[5] The same doctrine was announced in Osborn v. United States Bank.[6]

The power of the Federal Government to create a railroad corporation to act as its agent or instrumentality in the performance of a function of the Federal Government is equally clear.[7] The power of the Federal Congress to create a corporation for the purpose of constructing a bridge across navigable water between two states has likewise been upheld.[8]

Many more legal problems in part as yet unsolved are involved in the plan of the railroads. Among the most important of these problems are the means to be used to transfer to the new federal corporation the title to the property of the existing state corporation, with due regard to the rights of the stockholders of the state corporation, and the effect of federal railroad incorporation on the power of the states to regulate purely state commerce. I shall consider herein only the latter question. The effect of the proposed federal incorporation of the railroads on the powers of the states will be considered with reference to

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[3] 14 Stats. at L. 292.
[4] 16 Stats. at L. 573.
[5] (1819), 4 Wheat. 316, 4 L. Ed. 579.
[6] (1824), 9 Wheat. 738, 6 L. Ed. 204.
[7] California v. Central Pacific Rd. Co. (1887), 127 U. S. 1, 32 L. Ed. 150, 8 Sup. Ct. Rep. 1073.
[8] Luxton v. North River Bridge Co. (1894), 153 U. S. 525, 38 L. Ed. 808, 14 Sup. Ct. Rep. 891.

various classes of state powers in the following order: rates, taxes, securities, service, safety and police regulations.

### Rate Power of States.

The railroads frankly declare that it is their purpose to take from the states their entire power over railroad rates, specifically including their power over purely state rates. The railroads advocate the federal incorporation of the railroads principally for the purpose of accomplishing this end and contend that the federal incorporation of the railroads is a means adequate to accomplish their purpose.

The reports of the Supreme Court of the United States are full of decisions holding that under the commerce clause of the Constitution, the power of the Federal Government to regulate commerce is limited to commerce "with foreign nations, and among the several states, and with the Indian tribes," and that the states have the right to regulate purely state commerce as long as such regulation is not confiscatory and does not discriminate against commerce subject to the jurisdiction of the Federal Government.

The claim now urged by railroad lawyers that by reason of its control over the instrumentalities of interstate commerce the Federal Government has complete control over each railroad to any extent engaged in interstate commerce, even as to rates for purely state transportation, finds greater comfort in the hopes of these lawyers than in the decisions of the Supreme Court of the United States. It is unquestionably the prevailing opinion among well informed constitutional lawyers that the railroads cannot prevail in their campaign to take from the states their power over purely state commerce unless they shall first have persuaded the people of the United States to amend the commerce clause of the Constitution so as to take from the states the powers which apparently have been reserved to them.

However, a number of decisions of the Supreme Court of the United States, dealing specifically with railroads incorporated by the Federal Government, lend strong support, on an entirely different theory, to the plan of the railroads. These cases strongly intimate that if the Federal Government, in incorporating a federal railroad corporation, declares that such railroad shall be used for military purposes and shall be a post road and

clearly expresses the intention that such railroad shall not be subject to regulation by any state, such railroad will be subject to the exclusive control of the Federal Government in all matters, including purely state transportation. This conclusion is reached, apparently not under the commerce clause, but under the military power of the Federal Government and under its power "to establish post offices and post roads."

In Reagan v. Mercantile Trust Company,[9] decided on May 26, 1894, the Mercantile Trust Company brought an action against the Railroad Commission of Texas and the Texas and Pacific Railway Company, to restrain the enforcement, as against the Texas and Pacific Railway Company, of the Railroad Commission Act of the State of Texas. The Mercantile Trust Company was trustee under an issue of bonds of Texas and Pacific Railway Company. The Mercantile Trust Company and the Texas and Pacific Railway Company both earnestly contended that Texas and Pacific Railway Company, being a federal corporation, was not subject to the control of the State of Texas, even as to rates for transportation wholly within the state. Mr. Justice Brewer, in presenting the opinion of the Supreme Court of the United States, held that this contention was unsound for the reason that there was nothing in the language of the act incorporating the Texas and Pacific Railway Company to justify the claim that the Federal Government had shown an intention that this railroad should be removed from the jurisdiction of the State of Texas in purely state affairs. Mr. Justice Brewer says:[10]

> "Similarly we think it may be said that, *conceding to Congress the power to remove the corporation in all its operations from the control of the State,* there is in the act creating this company nothing which indicates an *intent* on the part of Congress to so remove it, and there is nothing in the enforcement by the State of reasonable rates for transportation wholly within the State which will disable the corporation from discharging all the duties and exercising all the powers conferred by Congress. By the act of incorporation Congress authorized the company to build its road through the State of Texas. It knew that, when constructed, a part of its business would be the carrying of

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[9] (1894), 154 U. S. 413, 38 L. Ed. 1028, 14 Sup. Ct. Rep. 1060.
[10] Reagan v. Mercantile Trust Co., supra, n. 9, at p. 416.

> persons and property from points within the state to other points also within the State, and that in doing so it would be engaged in *a business, control of which is nowhere by the Federal Constitution given to Congress.*" (Italics mine).

Continuing, Mr. Justice Brewer says:

> "It must have known that, in the nature of things, the control of that business would be exercised by the State, and *if it deemed that the interests of the nation and the discharge of the duties required on behalf of the nation from this corporation demanded exemption in all things from state control, it would unquestionably have expressed such intention in language whose meaning would be clear.* Its silence in this respect is satisfactory assurance that, in so far as this corporation should engage in business wholly within the State, it intended that it should be subjected to the ordinary control exercised by the State over such business." (Italics mine).

It will be observed that Mr. Justice Brewer was willing to concede, for the purpose of this decision, that Congress has the power to remove a federal railroad corporation in *all* its operations from the control of the state, but that he based his decision on the fact that the charter of the Texas and Pacific Railway Company did not show an *intention* on the part of the Federal Government to thus exempt the Texas and Pacific Railway Company from state control in state affairs. This position of the Supreme Court is all the more significant in view of the fact that the briefs of counsel for the Mercantile Trust Company and the Texas and Pacific Railway Company specifically drew the attention of the Supreme Court to the fact that the incorporation of the Texas and Pacific Railway Company could be sustained not merely under the commerce clause, which clause has always been construed to contain a limitation reserving to the states the power to regulate purely state commerce, but also under two additional powers of the Federal Government, the one power being the military power and the other the power to etsablish post roads. Under the language of the Federal Constitution, neither of these two powers is subject to any limitation with reference to state lines.

In Smyth v. Ames,[11] decided on March 7, 1898, certain stockholders of Union Pacific Railway Company brought an

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[11] (1898), 169 U. S. 466, 42 L. Ed. 819, 18 Sup. Ct. Rep. 418.

action against the railway and certain public officials of the State of Nebraska to enjoin the enforcement as against the Union Pacific Railway Company of an act of the Legislature of Nebraska regulating railroads and fixing maximum freight rates. It was urged by the stockholders of the railway company that Union Pacific Railway Company was a federal corporation and that under its charter the Federal Government had reserved to itself the exclusive control of rates, both interstate and purely state. Mr. Justice Harlan, in delivering the opinion of the Supreme Court of the United States, held that the language of the federal charter could not reasonably be construed so as to reserve to the Federal Government these exclusive powers. Mr. Justice Harlan refers with approval to the language hereinbefore quoted from Reagan v. Mercantile Trust Company and concludes (at page 522) as follows:

> "Until Congress, in the exercise either of the power specifically reserved by the eighteenth section of the act of 1862 or its power under the general reservation made of authority to add to, alter, amend or repeal that act, prescribes rates to be charged by the railroad company, it remains with the States through which the road passes to fix rates for transportation beginning and ending within their respective limits."

This language contains a clear intimation that the Federal Government has the power, in incorporating a federal railroad corporation, to reserve to itself complete authority over such corporation, even as to purely state commerce. The intention to reserve such power, however, must be clearly expressed in the act of incorporation.

In the Minnesota Rate Case,[12] decided on June 9, 1913, Mr. Justice Hughes refers as follows to the contention of the Texas and Pacific Railway Company in the Reagan case:

> "It was insisted that this company was 'not subject to the control of the State, even as to rates for transportation wholly within the State,' the argument being that it was not within the state power to limit the Federal franchise to collect tolls. But the court held that the act of Congress did not go to the extent asserted but left the company, as to its intrastate business, subject to state authority."

Three times the Supreme Court of the United States, speak-

[12] (1913), 230 U. S. 352, 425, 57 L. Ed. 1511, 33 Sup. Ct. Rep. 729.

ing successively through Justices Brewer, Harlan and Hughes, has thus clearly intimated that if the Federal Government in incorporating a federal railroad clearly expresses the intention that such railroad shall not be subject to state control, the states will have no power over the railroad, even as to purely state commerce. It may be urged that in none of these three cases was the point necessary to the decision and that it would be a more sound doctrine to limit the exclusive control of the Federal Government under the military power and under the power to establish post roads, to matters of a military and postal nature and to hold that with reference to other classes of commerce the limitations of the commerce clause must govern. But it may be suggested that this qualification was not made in the decision in any of the three cases hereinbefore cited.

In view of these three decisions, I consider it to be entirely unsafe to support the proposition of federal incorporation of the railroads on the assumption that the power of the states over purely state commerce cannot be taken from the states, even under federal incorporation, without an amendment of the commerce clause of the Federal Constitution. If the plan of federal incorporation of the railroads should be successful, the railroad lawyers will undoubtedly argue before the Supreme Court of the United States, in confident reliance on the three decisions hereinbefore cited and on language showing the intention of the Federal Government, to be inserted in the statute, that the railroads have been entirely removed from control by the states, even as to all purely state matters, with the sole exception of the taxing power and police powers in matters "not vital," it being the intention, at present, to so word the general statute as to reserve these two powers to the states.

### Taxing Power of States.

As already indicated, the railroads are willing, as a matter of policy, to leave to the states, "for the present," their power to tax railroad property.

That the railroads could thereafter, by simply amending the federal incorporation statute, take this power, also, from the states, would seem to be clear from the decisions of the Supreme Court of the United States.

In Thompson v. Pacific Railroad,[13] it was urged that the Union Pacific Railway Company's property in Kansas was exempt from the payment of taxes levied by the state of Kansas, not under any specific language in the act of Congress incorporating this railroad, but "from the relations of the road to the general government."

The Supreme Court of the United States, speaking through Chief Justice Chase, distinguishes between the instrumentalities employed by the government and the property of the agents employed by the government, and holds that as long as Congress has not interposed to protect from state taxation the physical property of a federal railroad corporation, such property may continue to be taxed by the state. However, the Chief Justice holds that Congress may "exempt, in its discretion, the agencies employed in such services [referring to federal railroad corporations] from any state taxation which will really prevent or impede the performance of them." And (at page 590) the Chief Justice further holds that "in the absence of express legislation to that effect" federal railroad corporations continue, with reference to their physical property, to be subject to state taxation.

In Railroad Company v. Peniston,[14] the Supreme Court of the United States held, by a divided court, that the public authorities of the State of Nebraska might levy taxes on the physical property of Union Pacific Railroad Company, a federal railroad corporation, but not on its operations in the state. Justices Strong, Clifford, Miller and Davis held that the state tax under consideration was valid because it was merely a tax on the tangible property of the railroad and not on its operations. Mr. Justice Swayne concurred solely on the ground that Congress had not granted to the Union Pacific Railroad Company exemption from state taxation, but added that this railroad corporation "is a national instrumentality of such character that Congress may interpose and protect it from state taxation whenever that body shall deem it proper to do so." Justices Bradley and Field, dissenting, held that under its federal charter the Union Pacific Railroad Company is exempt from all state taxation. Mr. Justice Hunt also dissented. It seems entirely clear that if the

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[13] (1869), 9 Wall. 579, 19 L. Ed. 792.
[14] (1873), 18 Wall. 5, 21 L. Ed. 787.

Federal Act incorporating the Union Pacific Railroad Company had expressly exempted this railroad from state taxation, the State of Nebraska would have been deprived of the right to tax even the tangible property of Union Pacific Railroad Company located within its borders.

In Central Pacific Railroad Company v. California,[15] the Supreme Court of the United States said:

> "It may be regarded as firmly settled that although corporations may be agents of the United States, their property is not the property of the United States, but the property of the agents, and that a State may tax the property of he agents, subject to the limitations pointed out in Railroad Company v. Peniston."

The Supreme Court then continued as follows:

> "Of course, if Congress should think it necessary for the protection of the United States to declare such property exempted, that would present a different question."

From these authorities, the conclusion may fairly be deduced that if the Federal Government, in providing for the incorporation of a federal railroad, should clearly express the intention that such railroad shall not be subject to state taxation, no state would thereafter have the power to tax such federal railroad corporation, not even its tangible property located within the borders of the state.

### Power of States Over Securities.

That the Federal Government, under a plan of federal incorporation of the railroads, could provide, by appropriate language, for *exclusive* control over the issue by such railroads of capital stock, bonds and other evidences of indebtedness, seems entirely clear.

The Supreme Court of the United States has frequently held that whenever the Federal Government enacts legislation providing for regulation in a particular field of interstate commerce, the states may not thereafter lawfully exert any authority in that particular field of interstate commerce.[16]

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[15] (1896), 162 U. S. 91, 125, 40 L. Ed. 903, 16 Sup. Ct. Rep. 766.

[16] Northern Pacific Ry. Co. v. State of Washington (1912), 222 U. S. 370, 56 L. Ed. 237, 32 Sup. Ct. Rep. 160; Southern Ry. Co. v. Railroad Commission of Indiana (1915), 236 U. S. 439, 59 L. Ed. 661, 35 Sup. Ct. Rep. 309.

The matter would seem to be too apparent to necessitate further discussion.

### Power of States Over Service.

At the present time the various states exercise important powers with reference to the service, equipment and facilities of railroads. These powers include matters such as the quality and adequacy of the service; the adequacy of equipment, both passenger and freight; the construction, heating, lighting and sanitation of depot and station buildings; the number and stopping of trains; the construction of spur tracks; and the construction of physical connections between railroad tracks.

Under the decisions hereinbefore referred to, the Federal Government, under a plan of federal incorporation of railroads could provide that these powers, even as to purely state commerce, could be completely withdrawn from the states.

### Power of States Over Safety.

The states likewise exercise important powers over the safety of railroad construction and operation, from the point of view both of the railroad employees and of the traveling public. These powers include such matters as the investigation and prevention of railroad accidents; the establishment of proper operating rules; the maintenance of proper clearances, both vertical and horizontal; the installation of block or other signals and of interlocking devices; the condition and manning of equipment; and the safety of the construction and operation of railroad crossings.

Under the decisions hereinbefore referred to, the use of appropriate language in the Federal Incorporation Act would presumably withdraw from the states the exercise of all these powers over all railroads to any extent engaged in interstate commerce.

### Police Powers of States.

The states at the present time exercise important police powers, applicable to railroads, with reference to health, safety and morals. Although some constitutional lawyers have expressed the opinion that the Federal Government cannot interfere with the exercise by the states of their so-called "police powers," this view is in conflict with the decisions of the Supreme Court of the United States. The law of the land, as expressed by these decisions, un-

doubtedly is that as to interstate commerce the Federal Government has the power to enact regulations which shall supersede the police powers of the states.[17]

A familiar case of the exercise of state police powers over railroads is to be found in the laws of many of the southern states providing for separate coaches for whites and blacks. Under the decisions hereinbefore cited, the Federal Incorporation Act, either as originally adopted or thereafter amended, could undoubtedly provide that with reference to this matter as well as all other police matters the state should thereafter exercise no power whatsoever, in so far as any railroad to any extent engaged in interstate commerce is concerned.

### Effect of Railroad Plan.

With reference to the effect of the railroad plan on the powers now exercised by the states, it may be said that if the doctrine announced in the Reagan case and subsequent cases should be applied by the Supreme Court of the United States, the Federal Government, by the use of appropriate language in the Federal Incorporation Act, could deprive the states of *all* powers of any character whatsoever over any railroad to any extent engaged in interstate commerce.

The plan as actually proposed by the railroads is to deprive the states, "at present," of *all* such powers, with the exception only of the power to tax and the power to enact "non-vital" police regulations.

The effect of the railroad plan on the financial structures of the railroads themselves is a matter which requires the most serious consideration. The railroad plan provides, in effect, that the new federal railroad corporation shall take over the property of the existing state railroad corporation, subject to the entire outstanding indebtedness, and that the new federal railroad corporation shall issue its capital stock to an amount equal to the entire outstanding capital stock of the state railroad corporation. Whatever water exists in the railroad stock now outstanding is to be perpetuated, through the act of the Federal Government, in the

[17] Hipolite Egg Co. v. U. S. (1911), 220 U. S. 45, 55 L. Ed. 364, 31 Sup. Ct. Rep. 364; Hoke v. U. S. (1913), 227 U. S. 308, 57 L. Ed. 523, 33 Sup. Ct. Rep. 281; Sligh v. Kirkwood, (1915), 237 U. S. 52, 59 L. Ed. 835, 35 Sup. Ct. Rep. 501; Seven Cases of Eckman's Alterative v. U. S. (1916), 239 U. S. 510, 60 L. Ed. 411, 36 Sup. Ct. Rep. 190.

new capital stock which is to be issued by the new federal corporations.

As hereinbefore pointed out, the Newlands plan provided that the property of the existing state railroad corporations should be transferred to the new federal railroad corporations on the basis of the issue by the new federal corporations of securities not in excess of the *fair value* of the property which is to be transferred. This would seem to be not merely a fair proposition, but also a very necessary step in order to establish sound railroad financial structures in lieu of many which are now unsound. However, when Mr. Alfred P. Thom, who appears in behalf of the railroads before the Newlands Joint Committee, was asked by Senator Cummins whether the railroads would be willing to limit the issue of securities by the new federal corporations to the fair value of the property, Mr. Thom flatly refused to entertain such a proposition, stating that the issue of securities equivalent only to the fair value of the railroad properties "would result in the financial ruin of the world." (Transcript, p. 399).

Mr. Thom suggested, in reply to the argument that it would be most inadvisable to have the Federal Government compel the issue by the new federal corporations of large amounts of stock in excess of the fair value of the property, that the new stock might be issued without par value and that in this way the difficulty might be overcome. However, as Senator Cummins pointed out, such a solution of the problem would "simply delude the country." One of the chief causes of the financial difficulties in which many of the railroads now find themselves is that their outstanding securities are largely in excess of the fair value of their property. Additional funds for capital expenditures cannot be secured by these railroads from the sale of bonds for the reason that the amount of bonds already outstanding is equivalent to, or greater than, the fair value of the property, nor can such funds be secured from the sale of capital stock for the reason that there is little or no equity at present behind the existing capital stock and no possibility, under just and reasonable rates, of earning substantial dividends to be paid on new capital stock in addition to capital stock which was issued by the railroads for little or no consideration. The issue of capital stock without par value in lieu of the capital stock now outstanding would not add a single dollar to the value of the property or increase by

a single dollar the amount of net earnings available for dividends on capital stock, or in any way improve the present financial structure of the railroads. Unless the investors of our country are "deluded," as suggested by Senator Cummins, they will be very slow, as long as the financial structures of these railroads remain as they are, to purchase additional securities, either bonds or capital stock. These comments, of course, do not apply to railroads whose financial structures are sound.

Furthermore, the plan suggested by the railroads may involve most serious consequences with reference both to future railroad rates and to the price which the Federal Government will ultimately pay for the property of the railroads. As already pointed out, the new capital stock is to be issued, in effect, under compulsion of the Federal Government. Will not the railroads hereafter urge, under these circumstances, that the government is estopped from claiming that the property of the railroads is worth less than the amount of the securities the issue of which was thus compelled? Is this not one of the real reasons for the plan of federal incorporation proposed by the railroads? Is it not their desire to lay the foundation for hereafter urging increases in rates on the basis of the securities to be issued under compulsion of the Federal Government? And, furthermore, are they not attempting to lay the foundation for hereafter claiming a high value, based on the issue of such securities, when the people of the United States finally purchase this property? In either event, this aspect of the railroad plan is worthy of the most careful consideration from the American people.

In my opinion, entirely apart from other features of the plan, the railroad proposal should never be adopted except on the basis of the limitation of the issue of the new securities to the fair value of the property and on the basis of a proper relationship between the various classes of securities.

### Federal Incorporation Unnecessary.

The representatives of the railroads before the Newlands Committee repeatedly admitted that they can accomplish by direct legislation, such as by the amendment of the Interstate Commerce Act, everything which they hope to accomplish by the indirect instrumentality of federal incorporation. This admission is subject to the qualification that it may be possible, under a Federal

Incorporation Act passed in the exercise of the military power and the power to establish post roads, to take from the states powers which could not be taken from them under the commerce clause of the Constitution as it now reads.

Referring specifically to the control of the issue of railroad securities, Mr. Thom has repeatedly admitted that exclusive federal control of such issues can just as effectively be established, as a matter of law, by the passage of the Rayburn Bill or some other amendment to the Interstate Commerce Act, as by providing a plan of federal incorporation of the railroads.

Then why do the railroads advocate the enactment of the indirect means of federal incorporation when they can just as readily accomplish their purpose by dealing directly and openly by amending the Interstate Commerce Act? Is it because they think that they can more readily accomplish their purpose by indirect means which are not clearly seen and understood than by direct action in the open? The only answer given by the railroads is that before bankers would purchase railroad securities issued under federal control thereof, established by amendment to the Interstate Commerce Act, they would insist on having the legality of such amendment established by a decision of the Supreme Court of the United States. The railroads contend, on the other hand, that if federal incorporation were effected, these same bankers would purchase railroad securities thereafter issued, without questioning the legality of the machinery provided by the Federal Government.

These arguments of the railroads are, in my opinion, by no means persuasive. It would be a comparatively simple matter to take to the Supreme Court of the United States a test case raising the question as to whether the Federal Congress may, by direct amendment of the Interstate Commerce Act, provide for exclusive or any other regulation of the issue of railroad securities. Statutes involving important changes in matters affecting property interests as well as human rights, are constantly passed by the Federal Congress and in due course the Supreme Court of the United States passes thereon, adjudicating all questions of doubt. The most signal weakness in this position of the railroads is their assumption that no litigation would follow the adoption by the Federal Government of the railroad plan of compulsory incorporation of all the railroads. If this plan is adopted, I predict

that there will follow thereon the greatest flood of railroad litigation which the United States has ever known.

The only reason urged by the railroads in favor of accomplishing their purpose indirectly instead of directly is the desire of these bankers to have the indirect method adopted rather than the direct method. This reason, in my opinion, is entirely unsatisfactory from the public point of view.

### General Conclusions.

Finally, I desire to suggest a few general conclusions on the subject of federal incorporation of the railroads.

1. It cannot be said, as a general proposition, that federal incorporation of the railroads is necessarily inherently good or bad. For instance, a plan of federal incorporation of the railroads under which the amount of outstanding securities would be reduced to a reasonable amount, the financial structures of the railroads improved and their ability to secure the necessary additional funds enhanced, without at the same time taking away from the states their powers over essentially local matters would be regarded as a good plan by many public-spirited citizens who regard the present railroad plan as essentially bad. Hence it is necessary in passing judgment on a plan of federal incorporation of the railroads, to consider the details of the particular plan presented and then to determine whether that plan, with its details, is or is not desirable.

2. The plan of federal incorporation now presented by the railroads is, in my opinion, distinctly against the public interest. It is calculated to break down the entire machinery of public regulation without in any degree improving the unsound financial structures from which many of the railroads are suffering. Furthermore, it has inherent in it grave dangers to future rates and to the future price to be paid by the Federal Government for the properties of the railroads, as hereinbefore pointed out.

3. The entire purpose of the railroad plan would seem to be to escape regulation by the states and to perpetuate the existing railroad securities. Unless these purposes are commendable, the plan certainly should not be adopted.

4. When the framework of a Federal Incorporation Act has once been provided, even though necessary qualifications and limitations are at first contained therein, it will be a simple mat-

ter for a subsequent Congress to strike out the qualifications and limitations so that the railroad purpose will be completely accomplished.

5. No convincing reason has been shown why such legislation as may now be desirable should not be enacted directly by amendment of the Interstate Commerce Act or other direct legislation instead of by the indirect, devious method proposed by the railroads.

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